IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

J. A. McPherson, *Petitioner,* vs. Commissioner of Internal Revenue, *Respondent.*	No. 6550
J. H. Leighton, *Petitioner,* vs. Commissioner of Internal Revenue, *Respondent.*	No. 6551

BRIEF FOR PETITIONERS.

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BRIEF FOR PETITIONERS.

I.

STATEMENT OF FACTS.

Leighton's Inc., until its dissolution, was a corporation organized under the laws of California and during 1919 operated a cafeteria in Oakland under the cooperative plan for the mutual benefit of its officers and employees who were also its stockholders.

Said corporation filed its Federal tax return for the year 1919 on March 15, 1920, on the basis of its being a "personal service corporation" within the meaning of Section 218 of the Revenue Act of 1918. (Tr. p. 24.)

The corporation was dissolved on June 25, 1920, by decree of the Superior Court of the State of California. The sole asset of the corporation, which then consisted of $15,000 in cash, there being no known claims of any creditor, was immediately distributed to the stockholders in accordance with their respective holdings. (Tr. p. 23.)

Subsequently the Commissioner of Internal Revenue questioned the right of said dissolved corporation to personal service classification for tax purposes for said year, and on March 6, 1925, requested a waiver from the corporation extending the statutory period for assessment of taxes for the year 1919 until December 31, 1925, and until sixty days thereafter, or until March 1, 1926, in the event an appeal to the Board of Tax Appeals was not taken prior thereto. Said waiver could not, of course, be furnished by a corporation no longer in existence, but a waiver was executed in the name of "Leighton's Inc., a dissolved Corporation" by three persons denominating themselves "Surviving Trustees" in manner following:

> "Leighton's Inc., a dissolved
> Corporation, Taxpayer
>
> By J. H. Leighton
> Jas. A. McPherson
> Carl Barthel
> Surviving Trustees." (Tr. p. 26.)

On September 29, 1925, purporting to act under said waiver, the Commissioner proposed an assessment against said dissolved corporation in the sum of $7986.53 for the year 1919, on the ground that the

corporation was not in that year a personal service corporation, and thereafter and in January, 1926, the Commissioner assessed a tax in that sum against said dissolved corporation. (Tr. pp. 25, 26.)

No further proceedings were ever commenced, taken or had by the Commissioner against said dissolved corporation respecting said assessment or to collect said tax. Instead, the Commissioner waited until after the enactment of the Revenue Act of 1926, and then on February 21, 1927, purporting to proceed under Section 280 of said Act, sent "sixty-day letters" to such of the former stockholders of the dissolved corporation who could be found, including the petitioners, purporting to assess a tax against them as *transferees.** Within the time provided by law, the petitioners appealed from the proposed assessment to the Board of Tax Appeals, and this proceeding was brought to review an adverse decision of the Board therein. (Tr. p. 26.)

II.

ASSIGNMENTS OF ERROR.

The United States Board of Tax Appeals erred in its decision herein in each of the following respects and particulars:

1. In holding that a waiver of the period of limitation for the assessment of additional income or profits taxes for the taxable year 1919, under the Revenue Act of 1918, executed by persons

*Italics throughout are ours.

styling themselves as trustees of a dissolved corporation, extended the period for the assessment and/or collection of such taxes from such dissolved corporation, or its stockholders, as transferees or otherwise.

2. In holding that a waiver of the period of limitation for the assessment of additional income or profits taxes for the taxable year 1919, under the Revenue Act of 1918, executed by persons styling themselves as trustees of a dissolved corporation, in any way affects or binds the former stockholders of such dissolved corporation so as to fasten upon them, or any of them, liability for such taxes, or to authorize or permit proceedings against any of such former stockholders, as transferees, under Section 280 of the Revenue Act of 1926, or otherwise.

3. In holding that this proceeding was not barred by Section 250 (d) of the Revenue Act of 1918, Section 277 (a) of the Revenue Act of 1924, and Sections 277 (a), 280, 1106 (a) and 1109 of the Revenue Act of 1926.

4. In holding that said assessment, if valid, did not constitute a proceeding pending for the enforcement of tax liability at the time of the enactment of the Revenue Act of 1926 so as to exclude petitioner from the provisions of, and any liability under, Section 280 of said Act.

III.

ARGUMENT.

1. THERE CAN BE NO LIABILITY OF A TRANSFEREE IF THERE IS NO ENFORCEABLE LIABILITY OF THE PRIMARY OR CORPORATE DEBTOR FOR THE TAX.

(a) Proceedings Against Transferees Are Now Wholly Statutory.

These proceedings were commenced against the petitioners under Section 280 of the Revenue Act of 1926, as transferees of a portion of the assets of Leighton's, Inc., a dissolved California corporation, to recover Federal income tax which the Government now claims should have been paid by the corporation for the taxable year 1919. Said section, in so far as material here, provides:

> "(a) The amounts of the following liabilities shall, except as hereinafter in this section provided, be assessed, collected and paid in the same manner and subject to the same provisions and limitations as in the case of a deficiency in a tax imposed by this title. * * *
>
> (1) The liability, at law or in equity, of a transferee of property, of a taxpayer, in respect of the tax * * * imposed upon the taxpayer by this title or by any prior income, excess profits or war profits tax act.
>
> * * * * * * *
>
> (b) The period of limitation for assessment of any such liability of a transferee or fiduciary shall be as follows:
>
> (1) Within one year after the expiration of the period of limitation for assessment against the taxpayer; or*

*As hereinafter shown, the respondent relies on this limitation, but claims the period was further extended by the waiver mentioned in the statement of facts.

> (2) If the period of limitation for assessment against the taxpayer expired before the enactment of this act but assessment against the taxpayer was made within such period—then within six years after the making of such assessment against the taxpayer, but in no case later than one year after the enactment of this act. * * *"

Until the enactment of Section 280, the respondent had no authority to proceed against transferees of assets of corporations, except by suit in equity, in the nature of a proceeding supplementary to execution under the "trust fund doctrine."

Section 280 is entirely procedural, and does not create any liability whatsoever, but as it clearly states, merely provides a new, and quasi-judicial remedy, for enforcing a liability that exists by virtue of some other provision or doctrine of law. Such was the declaration of the Senate Finance Committee, in its Report No. 52, dated January 22, 1926, when it proposed the new procedure. Quoting from said report:

> "It is the purpose of the committee's amendment to provide for the enforcement of such liability to the government by the procedure provided in the act for the enforcement of tax deficiencies. *It is not proposed, however, to define or change existing liability.* The section merely provides that if the liability of a transferee exists under other law then that liability is to be enforced according to the new procedure applicable to tax deficiencies. * * *"

The Supreme Court likewise so held in

Phillips v. Commissioner, 283 U. S. 589.

Therefore, unless there was at the time of the commencement of this proceeding an enforceable liability of the dissolved corporation, there can be no foundation whatsoever for these proceedings.

United States v. Updike, 281 U. S. 489.

As will be presently shown, the dissolved corporation was not liable to assessment at the time notice was sent to it on September 29, 1925, and regardless of other defenses, these proceedings cannot now be maintained against the petitioners as transferees.

(b) The Period of Limitation for the Assessment of the Dissolved Corporation Expired Prior to the Time the Purported Assessment Was Made Against It.

Leighton's, Inc. filed its Federal tax return for the year 1919 on March 15, 1920. By virtue of Section 250 (d) of the Revenue Act of 1918, then in effect, the Commissioner was required to determine and assess the tax for said year within *five years* thereafter, and no suit or proceeding for the collection of the tax after that time was permitted.

The five-year period expired on March 16, 1925, and it is conceded that no assessment or other proceeding was commenced until many months after that date.

Although Section 277 (a) (2) of the Act of 1926 extended the period for collection *after* assessment, it retained the same limitation upon assessment as provided in Section 250 (d), of the Act of 1918 so that the provisions of the later Act did not enlarge or otherwise change the limitation upon assessment.

The assessment here involved was proposed against the corporation more than five years after its dissolution, and manifestly was too late, unless the waiver hereinafter mentioned can be said to have extended the period for assessment. If there were any basis for doubting that the aforesaid limitation is controlling, we need only cite Section 1109 of the Act of 1926, which provides with respect of taxes under prior acts that it shall not

> "authorize the assessment of a tax or the collection thereof by distraint or by proceeding in court if at the time of the enactment of this Act such assessment, distraint or proceeding was barred by the statutory period of limitation properly applicable thereto unless prior to the enactment of this Act the Commissioner *and the taxpayer* agree in writing thereto."

Nor is the fact that an assessment was made against the corporation in January, 1926, of any moment, for if such assessment had any legal force whatever, so as to justify an assessment or proceeding against transferees under Section 280, it would have to come within the limitation of subdivision (b) (2) of said section, which authorizes proceedings thereunder against transferees only.

> "If the period of limitation for assessment against the taxpayer expired *before* the enactment of this act, but assessment against the taxpayer was made within such period. * * *"

The waiver relied upon by the Government by its terms expired December 31, 1925, or prior to the time said assessment was made against the dissolved cor-

poration, except that it contained the further provision that in the event a notice of deficiency was sent to the corporation and no appeal was taken by such corporation to the Board of Tax Appeals (and obviously none could be taken in this case because the corporation was not in existence), then the period of limitation would be extended a further period of sixty days, or until March 1, 1926.

Consequently, if any reliance is placed upon the assessment against the dissolved corporation made in January, 1926, the respondent must necessarily concede that the purported waiver extended the period of limitation until March 1, 1926, or until *after* the enactment of the Revenue Act of 1926, so as to take these proceedings out of the limitation of subdivision (b) (2) of Section 280, which is the only subdivision of that section dealing with assessments made against a transferor.

It follows, therefore, that the respondent must rely upon the limitation of subdivision (b) (1) of said section permitting proceedings against transferees within one year after the expiration of the period of limitation for the assessment of the transferor, or dissolved corporation in this case; and any proceedings under Section 280 against the petitioners, as transferees, are proceedings *de novo* and not founded in any way upon any assessment, actual or purported, against the dissolved corporation. This, we submit, identifies one of the principal errors of the Board in its decision herein, for the reason that under the express limitations contained in Section 280, the purported assessment made against the dissolved corpo-

ration necessarily becomes wholly irrelevant and immaterial to a proper determination of these proceedings.

Under the rule declared in *United States v. Updike, supra,* a transferee is entitled to every benefit and intendment of law to which a primary debtor is entitled, and in tax proceedings all doubtful interpretations, even as to limitations, must be resolved against the Government and in favor of such transferee.

(c) The Purported Waiver.

It is the respondent's contention, accepted by the Board of Tax Appeals, that the written waiver next mentioned extended the period of limitation for the assessment of the *dissolved corporation* so as to subject the petitioners to the new remedy provided in Section 280 of said Act.

On March 6, 1925, a waiver was executed by three persons as surviving trustees of Leighton's, Inc., a dissolved corporation which purported to extend the time for the assessment of a tax against the dissolved corporation until December 31, 1925, or sixty days thereafter if no appeal was taken by the taxpayer. The waiver plainly shows that the corporation had long since been *dissolved,* for the subscription by the three surviving trustees so declares. Consequently, respondent's case is premised upon the contention that a California corporation dissolved in 1920 may function as such after its legal dissolution, and that a waiver signed by surviving trustees may in some undisclosed manner bind the former corporation and in turn the stockholders of the corporation.

(d) The Corporation Having Been Dissolved, No Waiver Could Extend the Period for Action Against It as a Corporation.

The record shows that Leighton's, Inc. was dissolved by decree of the Superior Court of the State of California on June 25, 1920, pursuant to Sections 1227 to 1232 of the Code of Civil Procedure of this State. By virtue of said decree the corporate entity of Leighton's, Inc. was destroyed, and the corporation was legally and in fact dead for all purposes.

Van Landingham v. United Tuna Packers, 189 Cal. 353, at 371.

In this connection it is to be noted that until a new section was added to the Civil Code by the Legislature of 1929, it was the settled law of California that the existence of a corporation once dissolved, ended for all purposes. By the addition of Section 401 to the Civil Code in that year, which was nine years after the dissolution of the corporation here involved, provision was made for continuing the corporate existence for purposes of liquidation, as is also true of the laws of certain other jurisdictions. This distinction between the law of California and that of certain other states was clearly stated in the case of *Crossman v. Vivienda Water Co.,* 150 Cal. 575, at 580, wherein our Supreme Court stated:

> "It is settled beyond question that, except as otherwise provided by statute, the effect of the dissolution of a corporation is to terminate its existence as a legal entity, and render it incapable of suing or being sued as a corporate body or in its corporate name. It is dead, and can no more be proceeded against as an existing corporation

than could a natural person after his death. There is no one who can appear or act for it, and all actions pending against it are abated, and any judgment attempted to be given against it is void. As to this, all the text-writers agree, and their statement is supported by an overwhelming weight of authority. There is no statute of this state that authorizes the commencement or continuance of an action against the corporation after its legal death. *We have no statute similar to that of several states, providing that in the event of the dissolution of a corporation its existence shall be continued either indefinitely or for a specified time for the settlement of its affairs.*"

The same distinction is stated in *Fletcher Cyc. Corporations,* Vol. 8, p. 9173, et seq. to be as follows:

"When a corporation is dissolved by an absolute repeal of its charter under a reservation of the power to repeal the same, by expiration of the time limited in its charter, by a surrender of its charter accepted or authorized by the legislature, by a valid judgment forfeiting its charter, or in any other legal mode, *it no longer exists for any purpose,* unless there is some statutory provision continuing its existence, and therefore, as will be shown more specifically in the following sections, it no longer has any capacity or power either to enter into contracts, or to take, hold or convey property, or to sue or be sued, or to exercise any other franchise or power conferred upon it by its charter. Like a dead natural person, it has ceased to have any existence. After dissolution a corporation can exercise no powers except such as are conferred by the governing statute for the purpose of winding up its affairs.

> The effect of a dissolution, independently of statute, is not different whether the dissolution is accomplished ipso facto by the occurrence or omission of an act, or by a judicial decree."

The law of California is summarized again in *Sharp v. Eagle Lake Lumber Co.,* 60 Cal. App. 386, at 389, as follows:

> "These legal propositions are thoroughly established and unassailable: 1. That when a corporation has been dissolved according to the provisions or mandates of the law, or its charter has been legally revoked, from the date of either event such corporation no longer exists as a legal entity; it is then legally dead, and it is no more capable of suing or being sued or of transacting any other business in its corporate name than is a natural person after passing from this life."

Upon its dissolution the corporation here involved could neither act nor authorize any one to act in its behalf, for it was dead for every purpose, as declared in *Nezik v. Cole,* 43 Cal. App. 130, at 136, in the following language:

> "* * * 'Statutes similar to our Section 400 of the Civil Code above quoted do not have the effect of continuing the existence of the corporation as cuestui que trust, or otherwise, so as to render it capable of defending actions in its corporate name.' "
>
> * * * * * * *

And at page 138:

> "* * * 'So far as the dead corporation itself was concerned there could be no *admission or*

estoppel. It could no longer be served with process, could not appear, *could not itself admit anything nor authorize anyone else to do so for it. It was legally dead.* (Crossman v. Vivienda Water Co., supra.) The action of counsel, who may have had authority to represent the defendant company prior to the termination of the period of its legal existence, could not, so far as that party was concerned, vitalize any proceedings taken in the abated action after the corporation ceased to exist.' * * *"

To the same effect:

Panzer Hamilton Co. v. Bray, 96 C. A. 460 at 464.

The fact that a dissolved corporation is dead, because of the fundamental proposition that corporations are created and dissolved by law, was held by the Supreme Court of the United States in *Oklahoma Gas Co. v. Oklahoma,* 273 U. S. 257, at 259, as follows:

"* * * It follows therefore, that, as the death of the natural person abates all pending litigation to which such a person is a party, dissolution of a corporation at common law, abates all litigation in which the corporation is appearing either as plaintiff or defendant. To allow actions to continue would be to continue the existence of the corporation pro hac vice. But corporations exist for specific purposes, and only by legislative act, so that if the life of the corporation is to continue even only for litigating purposes it is necessary that there should be some statutory authority for the prolongation. The matter is really not

> procedural or controlled by the rules of the court in which the litigation pends. It concerns the fundamental law of the corporation enacted by the State which brought the corporation into being."

Recently the distinction between dissolved and suspended California corporations was stated by this Court in *California Iron Yards v. Commissioner,* 47 Fed. (2d) 514. In that case a waiver was executed by the directors of a California corporation during the period it was suspended from certain activities because of its failure to pay its state tax. Since its existence had not been terminated and its power to defend actions and proceedings against it had not been stayed by virtue of the suspension, this Court held that the waiver had been properly executed and delivered. However, the distinction between such suspended corporations and dissolved corporations was stated, and it was declared that the rule would not apply to dissolved corporations, for the reason that they are dead for all purposes. Quoting from page 515 of the report:

> "* * * If by the laws of California the penalty for failure to pay the license tax was the forfeiture of its charter and the dissolution of the corporation, as was formerly the case, it might well be contended that in view of the fact that the corporation no longer exists, it could not take advantage of any law of the Federal Government authorizing a corporation to act in reference to Federal taxes for the same reason that a dead person could not act under laws authorizing living individuals to act."

The foregoing authorities establish beyond any doubt that once a California corporation has been dissolved by decree of the Superior Court of this State, its existence is ended for all purposes, and as stated by this Court in *California Iron Yards Co. v. Commissioner, supra,* no action can be taken in its name or in its behalf or against it "for the same reason that a dead person could not act under laws authorizing living individuals to act." As shown above, the period of limitation for the assessment of said corporation under Section 250 (d) of the Revenue Act of 1918 ended on March 16, 1925, and no assessment against it was made within that period, and moreover, no proceedings of any kind were commenced against the corporation within such period. Since the surviving trustees could not act in the name or on behalf of the corporation after its dissolution, it follows that the waiver was ineffectual to extend such period and the assessment made against the dissolved corporation in January, 1926, was utterly void.

So far as the petitioners, as transferees, are concerned, the construction of Section 280 most favorable to the Government would authorize the assessment of such transferees under subdivision (b) (1) thereof within one year after the expiration of the period of limitation for the assessment of the corporation, or until March 16, 1926. Since no assessment of any kind was ever proposed against these petitioners until February 21, 1927, or almost a year thereafter, it follows that these proceedings are barred by the several statutes of limitation already referred to, and

particularly barred by subdivision (b) (1) of Section 280.

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2. SECTION 400 OF THE CIVIL CODE OF CALIFORNIA DOES NOT AUTHORIZE THE SURVIVING TRUSTEES OF A DISSOLVED CORPORATION TO ACT IN BEHALF OF SUCH CORPORATION.

Section 400 of the Civil Code, as it existed at the time of the dissolution of said corporation, provided as follows:

> "Unless other persons are appointed by the court, the directors or managers of the affairs of a corporation at the time of its dissolution are trustees of the creditors and stockholders or members of the corporation dissolved, and have full powers to settle the affairs of the corporation, collect and pay outstanding debts, sell the assets thereof in such manner as the court shall direct, and distribute the proceeds of such sales and all other assets to the stockholders. Such trustees shall have authority to sue for and recover the debts and property of the corporation, and shall be jointly and severally personally liable to its creditors and stockholders or members, to the extent of its property and effects that shall come into their hands. Death, resignation or failure or inability to act shall constitute a vacancy in the position of trustee, which vacancy shall be filled by appointment by the superior court upon petition of any person or creditor interested in the property of such corporation. Such trustees may be sued in any court in this state by any person having a claim against such corporation or its

> property. Trustees of corporations heretofore dissolved or whose charters have heretofore been forfeited by law shall have and discharge in the same manner and under the same obligations, all the powers and duties herein prescribed. Vacancies in the office of trustees of such corporations shall be filled as hereinbefore provided."

There is nothing in the aforesaid section susceptible to the construction that the trustees of the creditors and stockholders provided for therein may proceed in the name or on behalf of the dissolved corporation. The language throughout negatives such construction, and every decision of the Courts construing the language of that or like provisions of law unequivocally declares that it merely authorizes the trustees named to act with respect of any assets coming into their hands in behalf of the creditors and stockholders of the dissolved corporation and not for the corporation. In addition to the authorities set forth in the first subdivision of this brief, we cite in this connection *Lewis v. Miller & Lux,* 156 Cal. 101, at 103, where the Court held that upon dissolution:

> "the machinery of the corporation has been superseded by that of the trustees in liquidation, and they cannot be allowed or required to perform further functions in their capacity as a corporation or as directors thereof."

See also:

7 *Cal. Jur.* 628.

Under said section of the Code the powers and duties of trustees of a dissolved corporation are of a

temporary nature and consist entirely of settling the affairs of the corporation and distributing the remaining assets. They act, therefore, as trustees of an express trust, and their powers are dependent upon and limited by their possession of assets of the former corporation which constitute the trust property. Under the laws of California, immediately upon dissolution, title to the assets of the dissolved corporation vests in the stockholders, subject only to the possession of the surviving trustees, for the purposes specified in Section 400.

Havemeyer v. Superior Court, 84 Cal. 327;
J. Joseph v. Commissioner, 6 B. T. A. 595, at 598.

Their authority to deal with said assets, therefore, depended upon the possession, and in this case, the record shows without contradiction that in 1920 the only asset of the dissolved corporation was distributed to the stockholders. From and after that time there were no assets, and, therefore, no subject matter, and the trust was thereafter wholly inactive and ineffectual for any purpose.

Capuccio v. Caire, 189 Cal. 514.

Moreover, the waiver relied upon by the respondent herein does not purport to deal with any liability of transferees of dissolved corporations, nor to authorize any proceedings against transferees under a statute which had not then been enacted, such as Section 280 of the Revenue Act of 1926. At that time the only method by which a liability of a transferee of assets of a dissolved corporation could be enforced

was by means of a suit in equity under the trust fund doctrine.

Swan Land and Cattle Co. v. Frank, 148 U. S. 603.

And certainly the waiver here relied upon has nothing whatever to do with the commencement of a suit in equity against former stockholders of a dissolved corporation. It, therefore, follows that not only did the surviving trustees have no power to extend the period of limitation for the commencement of proceedings against any one except themselves, and this they did not do or purport to do in the waiver, but said waiver can not authorize any proceedings against either the dissolved corporation or the petitioners herein as transferees.

IV.

CONCLUSION.

It is respectfuly submitted that since the corporation was dissolved long prior to the time said waiver was given, and as the surviving trustees were not then authorized to act for or in behalf or in the name of said dissolved corporation, the waiver was ineffective to extend the period of limitation for the assessment of the dissolved corporation, with the result that such period of limitation expired on March 16, 1925, or almost three years before these proceedings were commenced. The Government at most had one year after March 16, 1925, within which to commence proceedings against the petitioners, as transferees, and the

record herein shows without contradiction that these proceedings were not commenced until long subsequent thereto.

We submit that the decision and judgment of the Board of Tax Appeals should be reversed.

Dated, San Francisco,
November 14, 1931.

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